No. 14,821

IN THE

United States Court of Appeals

For the Ninth Circuit

KAL W. LINES,
Appellant,

vs.

FALSTAFF BREWING CO., et al.,
Appellees.

BRIEF FOR APPELLEES.

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STATEMENT OF FACTS.

Appellees are sixteen (16) creditors of the above estate whose claims aggregate $3,735.56. These claims, plus those of four other creditors, Edwin J. Marino, Pacific Coast Brands, Eagle Vineyard Products and Gallo Sales Company, were all duly presented for voting at the first meeting of creditors of the above estate by the attorneys in fact designated in the Powers of Attorney contained in their respective proofs of claim. Said twenty (20) claims aggregating $4,508.67 were so voted for John M. England, as Trustee of the above estate. There were voted for appellant, Kal W. Lines, only five (5) claims totaling $407.22. Only one (1) of the twenty (20) claims

voted for Mr. England, to wit, one claim for $193.85, of Pacific Coast Brands, which was voted by Mr. England personally, was not objected to by appellant.

While the record is somewhat obscure as to the exact nature and grounds of the objections made on behalf of appellant to the voting of the nineteen (19) claims for Mr. England, it would appear that said objections are based entirely upon an alleged impropriety of permitting these creditors to select a trustee herein. These claims were admittedly solicited by the Creditors' Committee of this bankrupt at the Board of Trade of San Francisco on the letterhead of the latter (which letter was signed by the five (5) members of the Creditors' Committee). (See Transcript of Record, page 49.) Although at the beginning of the hearing before the referee (T.R. 29) appellant's counsel appears to have raised some question concerning the alleged solicitation of these claims for voting purposes by the Board of Trade, near the end of the hearing appellant asserts that "we make no charge . . . of improper solicitation. Mr. Shapro knows there was no indication of it when we went over these claims." (T.R. 38.)

Under these circumstances, appellees contend that the only basis upon which they, as creditors, could properly have been disenfranchised by the Referee in Bankruptcy and their preponderance of voting claims, in both number and amount, for Mr. England as Trustee disregarded and disapproved by the Referee's Order herein, was that their nominee, if elected, would have an interest adverse to the estate in ques-

tion and/or would not fairly and honestly administer same.

ARGUMENT.

1. The District Court was not in error in finding that "there is no evidence to support the Referee's finding that the votes of said appellees represented an attempt by them to retain some sort of control over the bankrupt estate for the benefit of said Board of Trade", for the reason that the finding by the Referee to the contrary was clearly erroneous and was not supported by substantial evidence and/or reasonable inferences.

A. THE STATUTES.

The Bankruptcy Act, Section 44(a), 11 U.S.C.A., Section 72(a), provides:

> "(a) *The creditors* of a bankrupt, exclusive of the bankrupt's relatives or, where the bankrupt is a corporation, exclusive of its stockholders or members, its officers, and the members of its board of directors, or trustees or of other similar controlling bodies, *shall,* at the first meeting of creditors after the adjudication . . . *appoint a trustee . . . of such estate.*" (Italics ours.)

Obviously, none of your appellees are within the class excluded from voting by the foregoing statutory provision. Prior to February 13, 1939, under General Order in Bankruptcy No. 13, 11 U.S.C.A., page 53, as of which date it was abrogated by the Supreme

Court of the United States, the appointment of a trustee by the creditors was "subject to be approved or disapproved by the Referee." We can find neither in the General Orders in Bankruptcy nor in the Bankruptcy Act itself any similar or revised provision giving the Referee in Bankruptcy any such specific authority. It would seem, therefore, that although prior to February 13, 1939 (under conditions which will be hereinafter discussed, and which are wholly inapplicable to the case at bar), the referee might have undertaken to disapprove the election of a trustee, under the law applicable to the case at bar, the referee obviously had no such jurisdiction. It should here be noted that the abrogation of former General Order No. 13 in February 1939 was made shortly after the Chandler Act Amendment to the Bankruptcy Act became effective in September 1938. Previously, Section 44(a) did not specifically provide the exceptions to the absolute right of creditors to appoint a trustee, hence the supervisory jurisdiction conferred upon the referee by the Supreme Court's General Order. The 1938 Amendment to Section 44(a) gives the specific exceptions, hence the supervisory powers of the Referee elections were deemed unnecessary.

B. DISCUSSION OF CASES CITED BY APPELLANT.

That a Bankruptcy Court is a court of equity and that the broad principles and rules of equity jurisprudence govern and apply in administration of a bankrupt estate is not disputed by appellees. How-

ever, the exercise of the equitable principles and the discretion conferred upon the referee in bankruptcy must be in conformity with the law, and as was stated by Judge Carter in his Memorandum and Order of March 31, 1955 (T.R. 84), the referee cannot "torture some adverse or conflicting interest . . .".

In appellant's opening brief at pages 6 and 7 cases are cited which, among others, are set forth by the Referee in support of his Order, both in his certificate and the Transcript of Record, page 27. *None* of the cases therein cited involved contested elections of a trustee in bankruptcy which took place after the abrogation of General Order No. 13. For that reason, we feel, they are not in point.

However, on the general subject of the alleged "adverse interest" and on the theory that even without such General Order, the Referee might possibly have power to sustain objections to the election as Trustee of a person disqualified by adverse interests, or by lack of personal qualifications and/or integrity. These cases will be discussed and distinguished.

In re Stowe, 235 F. 463, 38 Am. B.R. 76, was a case in which there was evidence that the bankrupt was involved in soliciting the claims for the disqualified candidate for the Trustee, and also indication that the attorney for the assignee for the benefit of creditors was attempting to control the election. No such facts appear in the instant case.

In re Leader Mercantile Co., (C.C.A. 5) 36 F. (2d) 745, 746, involves a situation where one Hall, who

received votes of the majority in number and amount of claims withdrew and took no further part after the Referee vetoed his election by reason of his activities in soliciting claims. Strangely enough, one of the points overruled by the court in that case was the alleged lack of authority in the Supreme Court to adopt General Order No. 13. The decision is based principally upon the now abrogated General Order No. 13 and, further restricts the rights of creditors to select the trustee *only* to the extent that their nominee be a "competent person". The court there holds that "competent" within the intent of the Act has a very broad meaning equivalent to "qualified" and fulfilling all the requirements of the case, and further, "while undoubtedly the policy of the courts is to permit the creditors to have the broadest latitude in the administration of the bankrupt's estate, nevertheless the courts are charged with the duty of supervision, and there is always the power in a court to intervene to prevent the selection of an *incompetent* person as trustee. *Of course, this power is not to be used arbitrarily but only for good cause, in the exercise of sound judicial discretion."* (Italics ours.) This latter quotation does not appear in the Referee's notes nor in the appellant's brief, and supports appellees' position herein.

In re Deena Woolen Mills, (D.C., Me.) 114 F. Supp. 260, 267, 268, involves an exaggerated and inflammatory situation where the attorneys for the assignee and the receiver solicited claims and where the attorney for the assignee for the benefit of creditors had been selected by the attorneys for the bankrupt. Solicita-

tion of claims by a receiver or his attorney is expressly prohibited by General Order No. 39, which reads as follows:

> "Neither a receiver nor his attorney shall solicit any proof of power of attorney, or other authority to act for or represent any creditor for any purpose in connection with the administration of an estate or the acceptance or rejection of any arrangement or plan."

Neither the Bankruptcy Act nor the General Orders prohibit anyone but a receiver or his attorney from soliciting claims. Not even an assignee for the benefit of creditors is so disqualified. (*Garrison v. Pilliod Cabinet Co., et al.,* 50 Fed. 2d 1035.)

Langnes v. Green, 282 U.S. 531, 541, 51 S.Ct. 243, 247, 75 L.Ed. 520, 526, is merely an admiralty case.

The case of *Delno v. Market St. Ry. Co.,* (C.C.A. 9), 124 F. (2d) 965, 967, is inapplicable to the case at bar, and merely defines the legal concept of a court's "discretion".

By statute, the unqualified right to appoint trustees in bankruptcy vests in the creditors. (*In re Harris Construction Company,* 37 F. (2d) 951, 14 Am. B.R. (n.s.) 641.) Approval or disapproval of their choice must be for reason, and based on the exercise of wise discretion. There must be reason for disapproval or removal.

In re Mayflower Hat Co., Inc., 65 F. (2d) 330;
In re Harris Construction Company, supra;
In re Bay Parkway Haberdashers & Hatters, Inc., 59 F. (2d) 103;

In re Van de Mark, (D.C.) 175 Fed. 287, Am. B.R. 760;

In re Malino, 118 F. 368, 8 Am. B.R. 205.

Remington on Bankruptcy, Fourth Edition, Volume 2, Section 1094, page 631, at 633:

"All must agree that the vital interest which creditors have in the preservation and wise management of the estate of the bankrupt, must, as a general rule, make them the best judges of who shall be appointed as trustee, and their selection cannot be arbitrarily ignored." (*Wilson v. Continental Building and Loan Association,* 232 F. 824, 37 Am. B.R. 444.)

"The choice of the creditors should not be overruled by the Referee or District Judge except for substantial reasons, and the confirmation by the District Judge of such appointment should not be disturbed by this Court unless an abuse of discretion appears." (*In re Merritt Construction Company,* 219 F. 555, 33 Am. B.R. 616.)

"If the persons appointed by creditors are competent to perform the duties, and if they have residence or an office in the District, the Creditors' appointment should be approved." (Remington on Bankruptcy, supra, page 633.)

"The policy of the Bankruptcy Act as shown in its provisions is to give to creditors of the Bankrupt the free, deliberate and an unbiased choice in the first instance of the persons who are to represent them and manage the assets of the Bankrupt estate. (*In re Lewensohn,* supra.) It cannot be denied that the vital interests which creditors have in the preservation and wise management of the estate of a bankrupt must as a

general rule make them the best judges of who shall be appointed as Trustee, and their selection cannot be arbitrarily ignored." (*Wilson v. Continental Building and Loan Association,* supra.)

In re Allied Owners Corp., Bankrupt, 4 F. Supp. 684, 24 Am. B.R. (n.s.) 151, involves a petition for review of an order disapproving an election of one Greve as trustee on the grounds of partiality in or connected with the transaction and affairs of the bankrupt, and wherein the Referee's order was reversed. The court discussed the rights of creditors in the election of a trustee, and, in finding that Greve was merely associated with affiliated companies of the bankrupt, held that this was not sufficient to disqualify him, and pointed out that his familiarity with the business enhanced his desirability.

"Courts should not assume that *creditors* cannot elect an impartial Trustee. *Their choice should be recognized and upheld unless contrary to law* or it appears that the Trustee so selected has interests which conflict with those of the general creditors of the bankrupt estate, (*In re Mayflower Hat Co.,* (C.C.A.) 65 F. (2d) 330, 331,) or unless there is reason for believing that the selection has been directed, managed, or controlled by the bankrupt or his attorney, or by some influence opposed to the creditors' interests. (*In re Eastlack,* (D.C.) 145 F. 68, 73.)

"The sole power conferred by the Bankruptcy Act on the Referee or judge in relation to the appointment of a Trustee is contained in Section 44 (11 U.S.C.A. 72, supra) where it is provided that, if the creditors do not appoint, 'the court

shall do so.' *The Act, therefore, contains no provision conferring on the Referee or judge the right to disapprove an appointment made by the creditors.* (*In re Krueger,* (D.C.) 196 F. 705, 707.) The right so to do is to be found in General Order 13 (11 U.S.C.A., p. 53) promulgated by the Supreme Court pursuant to statute, which provides: 'The appointment of a trustee by the creditors shall be subject to be approved or disapproved, and he shall be removable, by the referee or by the judge.'

"Thus *by this General Order courts of bankruptcy are vested with a supervisory power* to meet emergencies and exigencies which could not be foreseen or provided for in the statute. But the emergency must not be a trivial one. It should be of grave character and due weight, for *the effect of the use of this supervisory power is to disenfranchise the creditors and deprive them of rights expressly conferred upon them by statute.* (*In re Lloyd,* (D.C.) 148 F. 92, 93.) Since this is the ultimate result of the use of this supervisory power, its use must be sparingly exercised with sound judicial discretion and not arbitrarily or capriciously." (Italics ours.)

The above indicates that even this limited supervisory power in the Court was derived from the now abrogated General Order No. 13.

In *Mayflower Hat Co., Inc.,* 65 F. (2d) 330, on principle, it cannot be perceived why an agent for a creditor should not be permitted to vote as a creditor might, if by so voting he is not disqualified to vote for himself to act as trustee. If the creditors

who have unsecured claims filed and allowed . . . may vote for themselves, they may authorize agents to vote, and the majority of creditors in number and amount may control the election, and their choice must be upheld by the court, unless it appears that the trustee so elected has no interest adverse to the bankrupt estate.

See, also:

In re Lazoris, (D.C.) 120 F. 716;
In re Van de Mark, (D.C.) 175 F. 287.

In *In re Cass and Daley Shoe Co.,* 11 F. (2d) 872, held that if openly and honestly organized and conducted, a Creditors' Committee in bankruptcy proceedings may be of great assistance. Creditors' assignment of claims to Creditors' Committees was held not to disenfranchise them or the representative of such Creditors' Committee from voting for a trustee. The bankrupt may put itself into the hands of such a committee or in the hands of its principal creditors and such an act is not "collusion" in the sinister bankruptcy use of the word, *and these creditors have the right to vote for trustee.*

The Referee, in the order reversed by the District Judge, did exactly what the Circuit Court in the case of Cass and Daley Shoe Co., supra, disapproved, and the latter Court reversed an order of a referee similar to that of Referee Wyman in the instant case, which, by the order of the District Judge here appealed from, was also reversed.

As indicated above, at the hearing before the Referee, appellees, through their counsel, made a detailed

"offer of proof". (Ref. Cert., T.R. 31-33.) The relevancy of the evidence offered and so improperly rejected by the Referee is obvious from the context thereof in the light of the decisions above cited. In view of the fact that no contrary evidence was either offered or received, it would seem that the record is clearly devoid of evidence to support the Referee's disenfranchisement of appellees. If, as we contend, the offer of proof should have been accepted, the record would overwhelmingly support the propriety of the election of Mr. England by 20 creditors out of the 25 voted, and whose claims aggregated over 95% of the amount thereof.

The complete lack of control or even suggestion of the selection of Mr. England as their candidate by the Board of Trade, and/or the Creditors' Commiteee itself, was clearly indicated by the evidence so offered by appellees and refused by the Referee. The impartiality of the administratioin of the bankrupt's estate as to Mr. England himself was openly conceded by appellant (T.R. 35),

> "Mr. Shapro. . . . If I may, I should like to direct a question to Mr. Margolis in connection with this objection, so the record may be clear. I would like to know if it is your contention, Mr. Margolis, that if Mr. England's election as trustee in this case were approved by this Court, that he would administer this estate other than impartially, fairly and accurately?
>
> Mr. Margolis. Absolutely not. . . ."

and it is further emphasized and supported, without contradiction, by all of the evidence in the record and

that which was so offered and refused. (Referee's Finding No. 14 (T.R. 54).)

The Referee's decision in this case was not based upon "sound judicial discretion", was not used "sparingly", and was, in effect, arbitrarily exercised. We are at a loss to understand the action of the Referee in this case.

CONCLUSION.

At no time have appellees contended that the Referee has no jurisdiction, *in a proper case,* to sustain objections to and/or disapprove the election of a trustee by creditors whose interests are, or might be adverse to the bankrupt estate itself; but conversely, our position is that the Referee's actions in so doing "must be governed entirely upon statutory principles." The statute in question is Section 44(a) of the Bankruptcy Act, 11 U.S.C.A., Sec. 72(a), fully discussed above.

The only basis upon which these creditors could properly have been disenfranchised by Referee Wyman was *if* there was sufficient *evidence* that Mr. England, their nominee, would have an interest adverse to the estate and/or would not fairly and honestly administer same. (Ref. Cert. T.R., p. 38.) *The evidence received by the Referee* as well as that offered by appellees and refused by the Referee (Ref. Cert. T.R. 31 through last full paragraph p. 32), *is all to the contrary.*

As he said in his Memorandum and Order (T.R. p. 80), the District Judge gave full weight to the Referee's findings, but found them erroneous. Judge Carter's opinion (T.R. pp. 79-85) clearly indicates the full consideration given by him to the record, and his order of reversal (T.R. pp. 94-97) is amply justified.

We believe that there was neither substantial legal ground shown before Referee Wyman, nor any evidence upon which his contrary findings or conclusions could be predicated, justifying the disenfranchisement of the vast majority of the creditors who, including appellees, selected Mr. England rather than appellant to act as trustee of the above estate. The District Court's order of March 31, 1955 should be affirmed by this court.

Dated, San Francisco, California,
February 17, 1956.

Respectfully submitted,
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